



## Lowered Expectations

MEPCO announced weak 4Q18 results with SAR 0.25 EPS (-50% Y/Y) widely missing our SAR 0.56 forecast. 2018 highlighted the volatility of containerboard market, subject to end product prices, demand and material costs. In this note, we introduce our revised estimates for 2019 (lower revenues and tighter margins) and cut target price from SAR 29 to SAR 24, representing 10.2x 2020E EV/EBITDA. Not much besides costs are within the Company's control as market dynamics will remain in driver's seat. Global economic outlook is dimming for 2019, limiting scope for product price improvement. However, we believe shares are undervalued as small caps feel unloved ahead of EM index implementation.

### High single-digit price weakness drags topline

Although F2018 revenues increased +8% Y/Y to SAR 834 mln, driven by improved containerboard demand (406kt sold quantity), the performance in 1H was markedly varied from 2H. Increased contribution from non-conventional product (36.3%) failed to offset weaker product prices and demand (European destocking) as 4Q revenues fell -15% Y/Y to SAR 174 mln. We revised our 2019 revenue forecast lower by -2.4% to SAR 869 mln. In our view, flexibility to tweak exports will help offset weak domestic demand.

### Gross margin expected to normalize

Favorable OCP prices helped push gross margin to 28% in 2018 from 24% in the prior year as a result of stricter Chinese import regulations creating surplus supply. We believe margins will normalize in the mid-to-low 20% range, particularly as recycling efforts gain traction in KSA. Establishment of state-backed recycling entities could potentially create competition for WASCO in sourcing pulp.

### Earnings miss widely but better than expected cash DPS announced

EBITDA margin compressed to 24% from 27% in year ago period with expat levies as a contributing factor. Net income for the quarter declined -50% Y/Y to SAR 12 mln, missing our SAR 28 mln forecast. We cut our F2019 earnings estimate to SAR 87 mln (-12% Y/Y) from SAR 95 mln. MEPCO ended the year with SAR 588 mln net debt versus SAR 675 mln at end-2017. The Company announced better than expected 2H18 cash DPS of SAR 0.50 vs our SAR 0.25 estimate.

### Cutting target price to SAR 24, maintain Buy

Following our estimate revision through 2020, our target price for MEPCO drops to SAR 24 from SAR 29. We note that our revised estimates include slowing revenues and tighter margins, however given the unpredictability of demand and product prices, the Company could positively surprise. Second, we believe MEPCO will announce capacity expansion (initially expected at end-2018) to solidify its position as one of the leading regional producers – prompting potential favorable share price reaction. Maintain Buy.

**SAR 24**

**Buy**

12-Month Target price

Recommendation

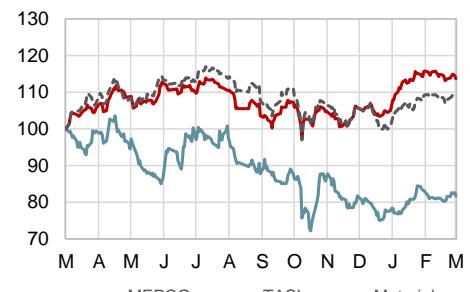
#### Stock Details

Last Close Price	SAR	20.94	
Upside to target	%	14.6	
Market Capitalization	SAR mln	1,047	
Shares Outstanding	mln	50	
52-Week High - Low	SAR	27.15 – 17.94	
Price Change (YTD)	%	4.8	
3-Mth ADTV	thd	300	
EBITDA 2019E	SAR mln	203	
Reuters / Bloomberg	1202.SE	MEPC AB	
<b>SAR mln</b>	<b>2018</b>	<b>2019E</b>	<b>2020E</b>
Revenues	834	869	861
Gross Margin	28%	25%	22%
EBIT	128	114	88
Operating Margin	15%	13%	10%
Net Income	99	87	64
Net Margin	12%	10%	7%
EPS (SAR)	1.99	1.75	1.28
DPS (SAR)	1.00	0.75	1.00

#### Price Multiples

	2018	2019E	2020E
P / E	10.5x	12.0x	16.3x
EV / EBITDA	7.6x	8.1x	9.4x
P / S	1.3x	1.2x	1.2x
P / B	1.4x	1.2x	1.2x

#### 1-Year Share Performance (rebased)



Source: Bloomberg, Tadawul, SFC

SAR mln	4Q18	4Q18E	4Q17	Y/Y Chg	3Q18	Q/Q Chg	Variance
Sales	174	208	205	-14.9%	216	-19.1%	-16%
Gross profit	45	57	54	-15.5%	65	-30.3%	-20%
Gross margin	26.0%	27.3%	26.2%		30.2%		
EBITDA	41	58	55	-24.2%	59	-29.7%	-28%
EBITDA margin	23.7%	27.8%	26.6%		27.3%		
Operating profit	20	35	31	-37.1%	37	-46.6%	-44%
Operating margin	11.3%	16.9%	15.3%		17.1%		
Net income	12	28	24	-49.8%	30	-59.3%	-57%
Net margin	7.0%	13.6%	11.9%		14.0%		
EPS (SAR)	0.25	0.56	0.49	-49.8%	0.60	-59.3%	-57%

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## Research and Advisory Department

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### Rating Framework

#### BUY

Shares of company under coverage in this report are expected to outperform relative to the sector or the broader market.

#### HOLD

Shares of company under coverage in this report are expected to perform inline with the sector or the broader market.

#### SELL

Shares of company under coverage in this report are expected to underperform relative to the sector or the broader market.

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